



APPENDIX "B" TO NOTICE OF BOD MEETING FOR JANUARY 22, 2007

Management Discussion and Analysis Year Ended September 30, 2006

The following discussion and analysis should be read in conjunction with the Consolidated Financial Statements of Sustainable Energy Technologies Ltd. ("Sustainable Energy" or the "Company") and notes for the year ended September 30, 2006.

This management discussion and analysis contains certain forward looking statements and information relating to the Company, its subsidiaries and related corporations that are based on beliefs of management as well as assumptions made by and the information currently available to the Company as at January 1, 2006 this date needs to be changed unless filing within the week. The sufficiency of working capital and the estimated cost and availability of funding for continued commercialization and development are subject to certain risks, uncertainties and assumptions. Many factors could cause the actual results, performance or achievements of the Company to be materially different from stated.

Additional information relating to the Company is available on SEDAR at www.sedar.com

Core Business and Strategy

Sustainable Energy develops and manufactures advanced power inverters for the emerging alternative and renewable energy industry - solar photovoltaic ("PV") systems, small wind turbines, fuel cells and all forms of energy storage especially the new energy storage technologies. According to Clean Edge a leading research firm global demand for renewable energy is expected to grow rapidly from US\$39.9 billion in 2005 to US\$167.2 billion by 2015¹.

Our power inverters are based on a patented new approach to power conversion which directly links low voltage dc power source to the grid in a single bi-directional power conversion step and deliver industry leading electrical conversion efficiencies. Originally developed for the demanding fuel cell environment, a very simple and highly reliable power inverter platform, and standard control software supports product applications for all the major generation and storage technologies and is interchangeable between grid interactive and grid independent modes – the industry's first "universal inverter." We have products for solar and fuel cell applications and we are currently developing products for small wind turbines and grid interactive back up power systems.

Our most important product application is for grid-connected solar PV systems which are expected to play a leading role in meeting the increased demand for renewable energy. The value of the solar industry is projected to grow from US\$11.2 billion per year to US\$51.1 billion per year by 2015, roughly the same value as wind power. The value of the power electronics typically ranges from 10% to 12% of total system value.

Our flagship SUNERGYTM power inverter is the first to offer grid-connected solar photovoltaic systems the safety and performance advantages of lower operating voltages while delivering the electrical conversion efficiencies of competitive

solar inverters. The ability of the SUNERGY_(TM) to operate at full power over extended periods of time and at temperatures that exceed 50 degrees Celsius makes it a leader in hot weather markets such as those found in southern Europe and North America.

The SUNERGY_(TM) inverter is very competitive with the leading solar inverters on all the standard competitive criteria. These include electrical conversion efficiencies, maximum power point tracking and product reliability. The SUNERGY_(TM) inverter differentiates itself from mainstream solar inverters with (i) its superior thermal performance; and (ii) its patented low voltage approach to power conversion.

- Thermal Performance: Energy losses in the form of internally generated heat will degrade power electronics and shorten the operating life of an inverter. In hot climates, the ability to dissipate heat is reduced, and most power inverters will reduce power or shut off entirely to protect the electronics. Referred to as "thermal rollback" this phenomenon can have a very negative impact on total system performance. It is particularly serious where the inverter is required to operate at or near full power for extended periods of time. The SUNERGY'S_(TM) patented design significantly reduces the heat generated by the power electronics, enabling the inverter to operate at full power throughout the day in ambient temperatures in excess of 50° C. The result is better overall project economics. The greatest advantage will be realized in hot weather climates and where solar trackers are used to increase the power output of the solar array.
- Low Voltage Alternative: Low voltage inverters continue to be the mainstay of off-grid, battery-centric solar power systems. The advantages of a low voltage array are many, including (i) the inherent safety and reliability of lower operating voltages (ii) higher, more reliable total system performance, and (iii) greater flexibility in design layout and selection of modules.

To date however, the advantages of a low voltage array have not been available to grid-connected systems as the power electronics industry has not been able to deliver a low voltage inverter which has the electrical conversion efficiencies needed by the grid connected solar industry. Instead, virtually all grid-connected inverters use the same "open domain" technology which requires a comparatively high operating voltage (200 volts to 600 volts) in order to achieve the targeted electrical conversion efficiencies. This is notwithstanding that solar modules have very low voltage outputs – typically ranging from 12 volts to 48 volts and the direction in solar cell technology is to lower voltage to current ratios in order to reduce manufacturing costs.

To control the power output characteristics of solar array, the modules in the string must be precisely matched in size, the voltage to current ratio and in the orientation of the modules to the sun. This leaves no flexibility in the ability to choose modules by size or power characteristics to achieve other design considerations. The arrangement of modules in long strings also exposes the entire system to the risk of poorer performance from individual modules. If, by reason of manufacturing tolerances, or dirt, or even differences in orientation to the sun, one module is producing lower current the entire system will operate at the lower current level reducing the power output.

With a low voltage approach, the solar modules can be arranged in parallel, giving system designers much more flexibility in terms of module selection and layout. Most significantly, the parallel array significantly improves total system yields by reducing the system's exposure to the performance of individual modules.

Our business strategy for the SUNERGY inverter has three main objectives:

- First, we aim to prove the commercial value of the SUNERGY_(TM) inverter and build first product sales revenues based mainly on the superior thermal performance of the inverter. Our best markets will be found in southern Europe and North America.
- Second, we intend to market the SUNERGY_(TM) inverter in all markets as the "low voltage alternative" to mainstream high voltage inverters. We believe that given an alternative a sizable segment of the market will prefer the performance and safety advantages of the low voltage approach. Our plan is to partner with companies which have established distribution capabilities and the ability to quickly make the low voltage approach a mainstream alternative in the market. We also intend to negotiate licensing arrangements for other world markets.
- Third, we believe that the ability to quickly and inexpensively develop application specific products for emerging niche market applications will enable us to gain a competitive advantage. Examples include small wind turbines, solar concentrators and the new thin film technologies, as well as stationary fuel cell and flow battery technology applications where our low voltage approach and thermal performance differentiate our products from the mainstream.

Review of 2006 Operations

Anticipated product sales to the solar market did not materialize during fiscal 2006. This was due in large measure to an inability on the part of our partner to meet its start-up production targets for the SUNERGY_(TM) inverter resulting in an inability to supply potential sales orders in Spain. But it was also due, in part, to a dramatic shift in the distribution channels in Spain towards larger projects and a shortage of modules in the hands of conventional distributors. The module shortage caught many by surprise, including Free Power SL, which had previously projected more than 500 unit sales for 2006.

We were able to respond to this by the third Quarter of 2006, negotiating a large contract with one of Europe's leading manufacturers of solar PV modules to supply inverters to one of the "multi-megawatt" solar tracker projects in Central Spain. The contract, which represented almost 10% of the solar power market in Spain at the time, is important to Sustainable Energy as it positions the SUNERGY_(TM) inverter in this and other Southern European markets and serves as a base to build production volumes.

With the negotiation of the supply contract, we also restructured our relationship with Benmayor, and have since contracted with a Canadian contract manufacturer to build the modules making up the inverter for us in Canada and China in the short term. The modules are then shipped to Spain for final assembly and testing at a facility outside Barcelona. We have been shipping inverters under the supply contract since early November 2006, and we have agreed to accelerate deliveries beginning in the second quarter of fiscal 2007. We are increasing production to 200 units per month to fill the order, and to put ourselves in a position to supply other contracts. We are currently in discussions with a major Spanish company to

assemble the SUNERGY for Spain and other European markets. We have also negotiated relationships with local partners for logistics and for technical and after sales support of the product.

Our product development efforts during 2006 focused on three areas: (i) enhancing software and optimizing inverter performance (ii) integrating the capability of the inverter to operate with batteries in a grid interactive and a grid independent mode (iii) demonstrating the capability of the inverter to manage grid interactive small wind turbines.

- As part of our software development program we developed a new remote monitoring software package for the SUNERGY platform, which will be marketed under the SunergySoft™ brand name. SunergySoft™ which uses standard network protocols and can be connected to a network using standard off the shelf equipment provides real time data on a range of performance criteria.
- With funding from the US Air Force we developed a 2.5 kW off-grid version of the SUNERGY inverter. The off grid inverter which was developed in partnership with ElectroVaya Inc, a leading developer of lithium ion battery technology, was designed to integrate solar and battery power with conventional diesel generation to provide lower cost, more reliable and more sustainable power under extreme conditions. Unlike other off grid inverter products in the market, which must be protected from wind, sand and rain, it is impervious to the elements.
- Using the same basic platform used for the Air Force development we developed a 2.5 kW inverter for use with a unique micro-turbine developed and being marketed globally by Zephyr Corporation based in Tokyo Japan under the brand name Air Dolphin Mark Zero. The wind inverter will have the capability to connect the Air Dolphin to the power grid without the use of batteries but also to use the turbine to charge batteries for emergency back up situations. We have since signed a memorandum of understanding with Zephyr Corporation to develop a product for their Air Dolphin wind turbine for global markets, and to distribute a bundle consisting of their turbine and our inverter in the Canadian market.

2007 Priorities

Our main priority in 2007 is to generate product sales revenues from our SUNERGY™ series of inverters for the grid-connected solar PV market. We will continue to focus most of our marketing resources in Spain, especially on the solar tracker project markets, but also to build relationships with leading distributors and system integrators for grid connected solar PV systems in the major regions of Spain. The shortage of solar PV modules experienced in 2006 seems to have been overcome and module prices have declined in recent months. Not only will this make solar power projects much more attractive, it will create new demand for inverters from conventional distributors in Spain. Like many others, we continue to believe that Spain will show exceptional growth reaching as much as 400 MW per year from 2010.

There is interest in our products from Greece and Italy which have both introduced feed in tariffs. We have excellent relationships in Greece from marketing efforts there several years ago and we intend to pursue new project opportunities as resources allow. We will also update our UL listing and introduce the repackaged SUNERGY to the North American market by year end.

Our intention it to devote substantial resources to positioning the value of the low voltage inverter in the North American and European market. As noted our strategy is to partner with companies which have the market presence to make the low voltage approach a mainstream alternative to the high voltage inverters currently in the market. This may entail private labeling, product licensing or other OEM relationships.

Notwithstanding our continued focus on the main grid connected solar market, we believe that there is an excellent opportunity to grow revenues in the small wind power market. A significant barrier to the expansion of this market has been the absence of a reliable efficient grid interactive power inverter. We believe that the efficiencies and overall performance of the SUNERGY platform addresses this issue and is superior to competitive alternatives. Moreover, the interchangeability of the platform between grid connected and off grid applications means we can offer manufacturers of wind turbines the ability to market the same turbine product for off grid and grid connected applications.

Management Discussion of Financial Results

Sales Revenue

Revenue for the twelve months ended September 30, 2006 was \$157,869. Revenue in 2005 was \$230,021. The change was the result of lower product sales revenue, but an increase in engineering fees revenue and an increase in interest revenue partially offset the decline in sales. Product sales revenue was \$76,079 for 2006 as compared to \$200,219 for 2005.

Product sales revenue was less than forecast due mainly to the failure of our partner to meet its production startup targets but also due to the failure of its affiliate Free Power SL to meet their sales forecasts. In addition, production delays and a request from our customer to delay deliveries under the announced supply contract resulted in first deliveries being deferred until the first quarter of 2007. We now expect to deliver the entire order before the end of the current fiscal period.

Cost of Sales

The cost of sales represents the direct costs of building the inverters. It also includes the cost of raw materials used in the repair of existing units in the field. The costs of repair parts are transferred at cost.

Operations Expenses

Operations expenses for the period (including operating expenses funded by Solar Markets Limited Partnership) have increased from \$1,376,359 last year to \$1,550,404 this year. This was due mainly to increases in operations salaries to prepare for production of the SUNERGY 5. There was also an increase in marketing expenses for the solar inverters.

General and Administrative Expenses

General and administrative expenses have increased from \$486,017 for the comparable 2005 fiscal year end to \$640,963 for this period end. The higher expenses were attributable to higher stock based compensation expenses.

Interest Expense

Interest during the twelve months was \$104,281 compared to \$163,627 for September 30, 2005. These amounts are a combination of interest on the Energy Northwest note payable and dividends paid on the First Preferred Shares, which have been accrued and classified as interest expense.

Amortization

Amortization of development costs were \$480,547 in 2006 and \$480,547 in 2006. The Company did not capitalize any development costs in 2006. Amortization of capital assets decreased from \$90,861 in 2005 to \$63,112 in 2006. The increase in 2005 was mainly because equipment and dies purchased in the last half of fiscal 2004 received a full year of depreciation in 2005.

Net Loss

The net loss for the twelve months ended September 30, 2006 was \$2,742,589 by comparison to a loss of \$2,439,351 in the same twelve months last year.

Selected Annual Information

Cdn\$ (unaudited)	2006	2005	2004
Total revenues	157,869	231,021	1,687,793
Net Income (loss)	(2,742,589)	(2,439,351)	(798,716)
Per share	(0.04)	(0.05)	(0.02)
Per diluted share	(0.04)	(0.05)	(0.02)
Total assets	6,345,732	7,554,467	6,091,012
Total long term financial liabilities	455,929	399,813	1,274,475

Summary of Quarterly Results

2006					2005			
Cdn\$ (unaudited)	Qtr 4	Qtr 3	Qtr 2	Qtr 1	Qtr 4	Qtr 3	Qtr 2	Qtr 1
Total revenues	9,753	62,292	81,572	4,252	81,572	41,857	30,991	75,601
Net Income (loss)	(896,512)	(530,377)	(671,426)	(644,274)	(627,205)	(663,573)	(623,246)	(525,327)
Per share	(0.014)	(0.008)	(0.011)	(0.011)	0.012	(0.011)	(0.013)	(0.009)
Per diluted share	(0.013)	(0.008)	(0.011)	(0.011)	0.012	(0.011)	(0.013)	(0.009)

In 2005, first preferred shares representing \$1,012,295 were converted to common shares. These first preferred shares were shown as long term financial liabilities in 2004 and 2003.

Liquidity and Capital Resources

Liquidity, as measured by working capital, was \$1,579,669 at September 30, 2006 versus \$2,471,538 at September 30, 2005. Cash and short term investments was \$752,417 for the year end by comparison to 2,356,164 at September 30 2005. In contrast, component and finished product inventory was \$1,156,558 at September 30 2006 by comparison to \$389,993 for the previous year.

Cash outflow from operating activities was \$2,749,344 for 2006 compared to \$1,825,982 for 2005. This increase was mainly due to an increase in component inventory (\$776,565) over the previous year, but also in part due to increased investment in marketing and higher salaries for technical personnel. We exited the year with an average monthly burn rate from operations (excluding inventory purchases) of approximately \$164,000.

Over the coming year, working capital will be impacted by the spread between the investment in component inventory needed to build out inventory prior to delivery of the finished products and payment for the inverters. To address this spread we arranged a \$500,000 export financing credit with a Canadian Chartered Bank and the Export Development Corporation. The credit, which is secured by a general charge on corporate assets, bears interest at a rate of prime plus 2% and is repayable in eight (8) principal payments of \$62,500 beginning September 30 2007. The loan is guaranteed by the Export Development Corporation as to \$375,000 and by the Chief Executive Officer of the Company as to \$125,000. In addition, STG Markets Limited Partnership raised a total of \$2,190,000 in two tranches by the issuance of 94 Limited Partnership Units (LP Units) in July 2006 and 125 LP Units in December 2006. Under the Partnership Agreement Sustainable Energy has the right to and intends to acquire the LP Units for a total of 14,837,607 Common Shares (average \$0.15 per share).

Financial Instruments

The Company's accounts receivable, accounts payable and accrued liabilities constitute financial instruments. Based on available market information, and relative short periods to maturity, the carrying value of the Company's financial instruments approximates their fair value.

Off Balance Sheet Items

The Company has no off-balance sheet financial commitments other than the commitments for operating leases for premise and equipment, which have been disclosed in the notes to the financial statements.

Government Assistance

During the 2006 fiscal period, the Company entered into a Contribution Agreement with the National Research Council, Technology Partnership Canada (TPC) to fund a portion of the costs incurred for various product development and enhancement programs to a maximum of \$245,241 from December 12, 2005 to March 31, 2007. The Company has received \$35,241 and accrued \$50,749 of this against operating salaries. The Company is currently negotiating an extension of the agreement and expects to claim the balance over the next 12 months. A royalty of 1.9% of gross revenue after April 1, 2008 is payable until TPC has recovered one and a half times the amount advanced to the Company. The royalty potentially payable is \$367,861.

Transactions with Related Parties

The Company obtains the services of the Chief Executive Officer through a personal corporation owned by him. In 2006 the Company expensed \$150,000 (September 30, 2005 - \$150,000) as compensation. At September 30, 2006, Sustainable Energy owed the personal corporation a total amount of \$ 62,500. The Chief Executive Officer is also a director and directly and indirectly a major shareholder of the Company. Subsequently to the year end the Chief Executive Officer personally guaranteed an export financing credit with a Canadian Chartered Bank to the amount of \$125,000 in exchange for which he was granted share purchase warrants to acquire 300,000 Common Shares of the Company at a price of \$0.15 per share subject to approval of the TSX Venture Exchange. He also invested \$50,000 to acquire 5 LP Units of STG Markets Limited Partnership.

Disclosure of Outstanding Share Data

Issued Capital

As at September 30, 2006, 69,139,909 common shares were issued and outstanding. With the exercise of the Company's right to acquire LP Units of STG Markets Limited Partnership an additional 14,837,607 Common Shares will be issued.

Stock Options

The Company has issued options to directors, officers and employees of the Company to acquire common shares to the date of this report as follows:

Range of Exercise Prices	Outstanding Options			Exercisable Options	
	Options	Weighted Average Price	Weighted Average years to expiry	Options	Weighted Average Price
\$0.10 - \$0.16	950,000	\$0.12	0.98	950,000	\$0.12
\$0.17 - \$0.19	4,308,005	\$0.18	4.10	944,335	\$0.18
\$0.20- \$0.25	1,375,000	\$0.20	1.33	904,999	\$0.20
\$0.10- \$0.25	6,633,005	\$0.18	3.08	2,799,334	\$0.17

Purchase Warrants

The Company's purchase warrant capital to the date of this report is as follows:

Type	Warrants	Exercise Price	Expiry Date
Broker	345,000	\$0.20	Jul7 17, 2007
Broker	105,000	\$0.20	July 23, 2007
Broker	15,000	\$0.20	August 8, 2007
Broker	961,539	\$0.13	June 21, 2008

Evaluation and Effectiveness of Disclosure Controls and Procedures

Sustainable Energy has established and maintains disclosure controls and procedures in order to provide reasonable assurance that material information is made known to management and the Board of Directors in a timely manner. Due to the small size of the Company the responsibility for maintaining disclosure controls and procedures for the Company rests primarily with the Chief Executive Officer. Due to the limited resources, there is not sufficient segregation of duties in the internal controls of the Company. The certifying officer has however evaluated the effectiveness of the Company's disclosure controls and procedures as at September 30, 2006 and has concluded that notwithstanding the inability to ensure better segregation of duties the procedures are adequate and effective to ensure accurate and complete disclosures of material information to management, the board of directors and the public in accordance with applicable securities legislation



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Deloitte Report

To the Shareholders of
Sustainable Energy Technologies Ltd.

Deloitte

We have audited the consolidated financial statements of Sustainable Energy Technologies Ltd. as at September 30, 2006 and 2005 and the consolidated statement of cash flows for the period between those dates, in accordance with the requirements of the Canadian Institute of Chartered Accountants. Our responsibility is to express an opinion on these consolidated financial statements based on our audit.

Sustainable Energy Technologies Ltd. Consolidated Financial Statements

September 30, 2006

Our audit was conducted in accordance with the standards of the Canadian Institute of Chartered Accountants. We have not audited the consolidated financial statements of Sustainable Energy Technologies Ltd. for the period between September 30, 2006 and September 30, 2005, and we have not audited the consolidated financial statements of Sustainable Energy Technologies Ltd. for the period between September 30, 2005 and September 30, 2004. Our opinion is based on the consolidated financial statements for the period between September 30, 2006 and September 30, 2005, and on the consolidated financial statements for the period between September 30, 2005 and September 30, 2004.

Deloitte & Touche LLP

Chartered Accountants

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Auditors' Report

To the Shareholders of
Sustainable Energy Technologies Ltd.:

We have audited the consolidated balance sheets of **Sustainable Energy Technologies Ltd.** as at September 30, 2006 and 2005 and the consolidated statements of loss and deficit and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at September 30, 2006 and 2005 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

(signed) "Deloitte & Touche LLP"

January 4, 2007

Chartered Accountants

Sustainable Energy Technologies Ltd.
Consolidated Balance Sheets
As at September 30,

	2006	2005
ASSETS		
Current assets		
Cash and cash equivalents	\$ 339,006	\$ 170,745
Short term investments	413,411	2,185,419
Accounts receivable and advances	256,690	127,332
Inventory	1,156,558	389,993
	2,165,665	2,873,489
Development costs (note 4)	4,059,542	4,540,089
Capital assets (note 5)	120,525	140,889
	\$ 6,345,732	\$ 7,554,467
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities		
Accounts payable and accrued liabilities (notes 11 and 12)	\$ 471,996	\$ 299,948
Long-term debt, current portion (note 6)	114,000	100,000
First preferred shares, series 3 (note 7)	—	2,003
	585,996	401,951
Long-term debt (note 6)	455,929	399,813
	1,041,925	801,764
Shareholders' equity		
Share capital (note 9)	16,162,131	15,046,444
Warrants (note 9)	34,511	258,920
Contributed surplus	540,093	137,678
Deficit	(11,432,928)	(8,690,339)
	5,303,807	6,752,703
	\$ 6,345,732	\$ 7,554,467

These financial statements have been prepared using the policies described in notes 2 and 3.

See accompanying Notes to the Consolidated Financial Statements

On behalf of the Board:

{signed}
Michael Carten, Director

{signed}
Robert Penner, Director

Sustainable Energy Technologies Ltd.
Consolidated Statements of Loss and Deficit
Years ended September 30,

	2006	2005
Revenue		
Product sales	\$ 76,079	\$ 200,219
Engineering fees	47,823	10,566
Interest and other	33,967	19,236
	157,869	230,021
Expenses		
Cost of sales	79,819	80,074
Royalties (note 12)	4,433	16,429
Operations	1,550,404	1,376,359
General and administrative	640,963	486,017
Interest	104,281	163,627
Amortization of development costs	480,547	480,547
Amortization of capital assets	63,112	90,861
Foreign exchange gain	(23,101)	(24,542)
	2,900,458	2,669,372
Loss before taxes	(2,742,589)	(2,439,351)
Future income tax expense (note 13)	—	—
Net loss	(2,742,589)	(2,439,351)
Deficit, beginning of year	(8,690,339)	(6,250,988)
Deficit, end of year	\$ (11,432,928)	\$ (8,690,339)
Loss per share		
Basic and diluted	\$ (0.04)	\$ (0.05)
Weighted average number of common shares (note 10)		
Basic	65,439,302	47,948,097
Diluted	67,893,114	56,827,857

These financial statements have been prepared using the policies described in notes 2 and 3.

See accompanying Notes to the Consolidated Financial Statements

Sustainable Energy Technologies Ltd.
Consolidated Statements of Cash Flows
Years ended September 30,

	2006	2005
Cash provided by (used in)		
Operating activities		
Net loss	\$(2,742,589)	\$ (2,439,351)
Amortization of capital assets and development costs	543,659	571,408
Dividends on preferred shares (paid in preferred shares)	84	105,119
Stock based compensation	159,900	108,189
	(2,038,946)	(1,654,635)
Net change in non-cash working capital	(710,398)	(171,347)
Cash flow from operating activities	(2,749,344)	(1,825,982)
Financing activities		
Advances on long-term debt	77,925	51,716
Repayments on long-term debt	(7,808)	(8,199)
Proceeds on issuance of equity	1,411,016	4,033,500
Financing charges incurred	(279,312)	(324,905)
Net change in non-cash working capital	(11,396)	6,430
Cash flow from financing activities	1,190,425	3,758,542
Investing activities		
Capital asset additions	(42,747)	(15,596)
Short term investments	1,772,008	(2,185,419)
Net change in non-cash working capital	(2,081)	(34,688)
Cash flow from investing activities	1,727,180	(2,235,703)
Net change in cash	168,261	(303,143)
Cash and cash equivalents, beginning of year	170,745	473,888
Cash and cash equivalents, end of year	\$ 339,006	\$ 170,745

These financial statements have been prepared using the policies described in notes 2 and 3.

See accompanying Notes to the Consolidated Financial Statements

Sustainable Energy Technologies Ltd.

Notes to the Consolidated Financial Statements

September 30, 2006

1. OPERATIONS

Nature of operations

Sustainable Energy Technologies Ltd ("Sustainable Energy" or the "Company") develops and manufactures advanced power inverters for the emerging alternative and renewable energy industry - solar photovoltaic ("PV") systems, small wind turbines, fuel cells and all forms of energy storage especially the new energy storage technologies. The power inverters are based on a patented new approach to power conversion which directly links low voltage dc power source to the grid in a single bi-directional power conversion step. A standard power electronics platform and parametrically controlled software supports product applications for all the major generation and storage technologies and is interchangeable between grid interactive and grid independent modes.

Sustainable Energy's most important product application is for grid-connected solar PV systems. Its first high volume product for this market is a 5 kW inverter being marketed in Europe under the SUNERGYTM brand name.

2. GOING CONCERN ASSUMPTION

These consolidated financial statements are prepared on the going concern basis, which assumes that the Company will be able to realize its assets at the amounts recorded and discharge its liabilities in the normal course of business for the foreseeable future. Continuing operations are dependent upon the Company being able to generate additional working capital to fund future operations, increase sales and achieve profitability. The outcome of these events is uncertain at this time. These financial statements do not include any adjustments to the amounts and classification of assets and liabilities that may be necessary should the Company be unable to generate additional working capital, increase sales, achieve profitability and to continue as a going concern.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of consolidation of financial statements

The consolidated financial statements of Sustainable Energy Technologies Ltd. include the accounts of the Company and its subsidiaries: Sustainable Energy Systems Inc. ("SES"), Invertugar S.L. STG Markets Limited Partnership ("STGLP"), Sustainable Energy Laboratories Ltd. ("SEL"), CWT Power Inc and International Power Systems, Inc. ("IPS"). The consolidated financial statements of the Company have been prepared by management in accordance with Canadian generally accepted accounting principles.

Sustainable Energy Technologies Ltd.

Notes to the Consolidated Financial Statements

September 30, 2006

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Use of estimates

The preparation of Sustainable Energy's consolidated financial statements and related disclosures in conformity with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of these financial statements, and revenue and expenses during the period reported. Estimates include allowance for doubtful accounts, estimated useful life of development assets, deferred costs and capital assets; provisions for contingent liabilities and valuation allowance for future tax assets and reflect management's best estimates. By their nature, these estimates are subject to uncertainty and the effect on the financial statements of changes in estimates in future periods could be significant.

Cash and cash equivalents

Investments, with maturities of three months or less at the date of purchase are considered to be cash equivalents and are recorded at cost, which approximates fair market value.

Short term investments

Short term investments include term deposits and other highly liquid investments with maturities at the date of purchase greater than three months.

Inventory

Inventory is carried at the lower of average cost or net realizable value.

Research and development costs

Research costs are expensed as incurred. Development costs are expensed as incurred, unless they meet the criteria for deferral and amortization under Canadian generally accepted accounting principles.

Under these principles, costs incurred on the development of new products and technologies, which, in management's view, are clearly defined, have clearly defined market prospects, are technically feasible and for which the Company intends to commit resources and has resources available, should be deferred and amortized using the straight-line method over the estimated useful life of the technology. The balance is assessed on a regular basis to determine if it is recoverable and to determine the relevant amortization period. If not considered fully recoverable from future revenues, a write-down of the value will be taken.

Government assistance

Government assistance is utilized to fund the various research and development technologies of the Company. Government assistance, including contingently repayable government assistance, offsets the capitalized development costs or expenses to which it relates. Contingent government assistance repayments will be shown as a royalty expense when incurred.

Sustainable Energy Technologies Ltd.

Notes to the Consolidated Financial Statements

September 30, 2006

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Capital assets

Capital assets other than capitalized product development costs are recorded at acquisition cost. Amortization is charged over the estimated useful life of the asset at the following rates:

Furniture, equipment and leaseholds	5 years straight-line
Computer equipment	3 years straight-line
Computer software	1 year straight-line
Lab equipment	3 to 5 years straight-line
Dies and molds	1 year straight-line

Revenue recognition

Revenue from product sales is generally recognized on shipment to the customer and when reasonable assurance exists regarding the measurement and collection of the consideration received. There may be instances where customers will request that the Company "bill and hold" their shipments until such time as the customers are prepared to receive the shipment. In these cases, revenue is recognized when the customer is invoiced for the goods which have been packaged and made ready for shipment, the risk of ownership is with the customer, and the terms and collection experience on the related billings are consistent with all other sales.

Engineering fee revenue is recognized when the service is performed. Licensing fee revenue is recognized with the Company has fulfilled all its obligations under the terms of the operative licensing agreement. In all cases no revenue would be recognized in circumstances where collection is not reasonably assured.

Preferred Shares

Preferred shares have been classified as either a liability or as equity in accordance with the substance of the contractual arrangement.

Foreign currency translation

The subsidiary companies are considered to be integrated into the operations of the parent and therefore the temporal method has been used. Under this method, monetary assets and liabilities in foreign currencies are translated into Canadian dollars at the period-end exchange rate. Non-monetary assets and liabilities are translated at the rate of exchange prevailing at the transaction date. Exchange gains or losses are included in earnings for the period.

Income taxes

Income taxes have been recorded utilizing the liability method of accounting for future income taxes. Under this method, future tax assets and liabilities are measured using substantively enacted tax rates expected to apply to taxable income in the years in which temporary differences are expected to be recovered or settled.

Per share amounts

Basic earnings per share are computed based on the weighted average number of shares outstanding during the year. Diluted earnings per share are calculated in accordance with the treasury stock method. The treasury stock method assumes that proceeds received from the exercise of in-the-money stock options are used to repurchase common shares at the average market price during the period.

Stock-based compensation

The Company accounts for all stock option awards granted to employees, directors and others using the fair value based method whereby compensation costs are recognized when awards are issued. The fair value of stock options is determined by the Black-Scholes option pricing model with assumptions for risk-free interest rates, dividend yield, volatility factors of the expected market price of the Company's common shares and an expected life of the options. Consideration paid on the exercise of stock options and warrants is credited to share capital.

Sustainable Energy Technologies Ltd.

Notes to the Consolidated Financial Statements

September 30, 2006

4. DEVELOPMENT COSTS

	September 30, 2006			September 30, 2005		
	Cost	Accumulated amortization	Net book value	Cost	Accumulated amortization	Net book value
Development of Wind Turbine Technology	\$1,885,875	\$ 1,885,874	\$ 1	\$ 1,885,875	\$ 1,885,874	\$ 1
Development of Power Electronics Intellectual Property	4,274,662	1,068,646	3,206,016	4,274,662	801,479	3,473,183
Development of Power Electronics Platform	1,523,750	670,225	853,525	1,523,750	456,845	1,066,905
	\$7,684,287	\$ 3,624,745	\$ 4,059,542	\$ 7,684,287	\$ 3,144,198	\$ 4,540,089

The Company breaks down its deferred development costs into two categories.

- The cost of the development of the Company's intellectual property is \$4,274,662 and will be amortized straight line over the life of the relevant patents, which is estimated to be 16 years. At September 30, 2006 the patents had a remaining estimated useful life of 12 years.
- The costs of developing the Company's power electronics platform after deducting contributions to its development by RWE Piller GmbH and net of contributions made by Government agencies is \$1,523,750. The platform will be amortized straight line over its estimated life of 7 years. At September 30, 2006 the remaining life was estimated to be 4 years.

When Sustainable Energy was in the development stage, the Company deferred all costs (net of contributions from Government agencies) associated with developing its core technology and its first product application; a power electronics platform for grid-connected DC power sources. With the transition out of the development stage in the 2003, the Company began expensing all costs, except those meeting its deferral policy (see note 3).

5. CAPITAL ASSETS

	September 30, 2006			September 30, 2005		
	Cost	Accumulated amortization	Net book value	Cost	Accumulated amortization	Net book value
Computer equipment and software	\$ 177,397	\$ 158,065	\$ 19,332	\$ 163,342	\$ 138,070	\$ 25,272
Lab equipment	247,283	161,576	85,707	225,174	124,798	100,376
Furniture, equipment and leaseholds	73,816	58,330	15,486	67,232	51,991	15,241
Dies and molds	15,431	15,431	-	15,431	15,431	-
	\$ 513,927	\$ 393,402	\$ 120,525	\$ 471,179	\$ 330,290	\$ 140,889

Sustainable Energy Technologies Ltd.
Notes to the Consolidated Financial Statements
September 30, 2006

6. LONG-TERM DEBT

	September 30, 2006	September 30, 2005
<u>Energy Northwest note payable</u>		
The note payable to Energy Northwest (\$463,456 US) bears interest at an annual rate of 20%. Commencing January 1, 2001, repayment is required at 10% of SEL's gross monthly sales. This repayment is limited however by a minimum of \$7,000 per year and a maximum of 20% of the total investment by Energy Northwest. All payments are to be completed by January 1, 2016.	\$ 569,929	\$ 499,813
Less: Current portion of long-term debt based on management's sales forecasts for the next 12-month period	114,000	100,000
	\$ 455,929	\$ 399,813

7. FIRST PREFERRED SHARES

All first preferred shares have been converted to common shares. During the year ended September 30, 2006, the final 15,899 preferred shares series 3 paid a dividend to September 22, 2005 and were converted to common shares.

First preferred shares were subject to mandatory redemption by the Company on October 15, 2005 and were therefore treated as a current financial liability and not as equity. The cumulative dividend payments that accrued on these first preferred shares were classified as interest expense. Dividends were payable at the option of the Company in cash or in additional first preferred shares of the particular series based on a value tied to the average trading price of the common shares of the Company.

All first preferred shares were convertible at any time by the holder thereof into an equal number of common shares.

In 2005, the Company offered to pay a dividend to September 22, 2005 and redeem these first preferred shares in exchange for first preferred shares series 5. The first preferred shares series 5 carried the same terms and conditions as the series 3 except the redemption date was October 15, 2007 and they were to be converted if the 10 day closing average for the preceding 10 trading days equaled or exceeded \$0.30 per share after August 15, 2005. At October 15, 2005 the remaining preferred shares (15,899) of series 3 were exchanged for series 5 and converted to common shares.

Authorized, unlimited number

Voting first preferred shares, series 3, redeemable at \$0.12, 10% dividend.
Voting first preferred shares, series 4, redeemable at \$0.16, 5% dividend.
Voting first preferred shares, series 5, redeemable at \$0.12, 10% dividend.
Voting first preferred shares, series 6, redeemable at \$0.16, 5% dividend.

Sustainable Energy Technologies Ltd.
Notes to the Consolidated Financial Statements
September 30, 2006

7. FIRST PREFERRED SHARES (CONTINUED)

Issued first preferred shares, series 3

Changes in the Company's first preferred shares, series 3 are as follows:

	Number of Shares	Amount
Balance, September 30, 2004	4,212,798	\$ 504,569
Issued in lieu of cash dividend	384,339	74,805
Converted to common shares	(79,500)	(9,778)
Issued in exchange for first preferred shares, series 5	(4,501,738)	(567,593)
Balance, September 30, 2005	15,899	\$ 2,003
Issued in lieu of cash dividend	268	84
Issued in exchange for first preferred shares, series 5	(16,167)	(2,087)
Balance, September 30, 2006	—	\$ —

Issued first preferred shares, series 4

Changes in the Company's first preferred shares, series 4 are as follows:

	Number of Shares	Amount
Balance, September 30, 2004	2,573,075	\$ 404,610
Issued in lieu of cash dividend	155,695	30,314
Issued in exchange for first preferred shares, series 6	(2,728,770)	(434,924)
Balance, September 30, 2005 and 2006	—	\$ —

Issued first preferred shares, series 5

Changes in the Company's first preferred shares, series 5 are as follows:

	Number of Shares	Amount
Balance, September 30, 2004	—	\$ —
Issued in exchange for first preferred shares, series 3	4,501,738	\$ 567,593
Converted to common shares	(4,501,738)	\$(567,593)
Balance, September 30, 2005	—	\$ —
Issued in exchange for first preferred shares, series 3	16,167	2,087
Converted to common shares	(16,167)	(2,087)

Sustainable Energy Technologies Ltd.

Notes to the Consolidated Financial Statements

September 30, 2006

7. FIRST PREFERRED SHARES (CONTINUED)

Issued first preferred shares, series 6

Changes in the Company's first preferred shares, series 6 are as follows:

	Number of Shares	Amount
Balance, September 30, 2004	—	\$ —
Issued in lieu of cash dividend	2,728,770	434,924
Issued in exchange for first preferred shares, series 6	(2,728,770)	(434,924)
Balance, September 30, 2005 and 2006	—	\$ —

8. STG MARKETS LIMITED PARTNERSHIP

STG Markets Limited Partnership ("STGLP") (formerly Solar Markets Limited Partnership ("SMLP")) is an Alberta Limited Partnership which carries on the business of commercializing manufacturing and marketing inverters under license from Sustainable Energy and certain of Sustainable Energy's subsidiaries. The General Partner of STGLP is SES which exercises control over STGLP's operations. The Limited Partners of STGLP are Sustainable Energy, and from time to time, private investors who have provided capital to STGLP by purchasing limited partnership units ("LP Units") at a price of \$10,000 per LP Unit.

As Limited Partners of the Partnership on December 31 of each year, the investors are entitled to deduct their share of non capital losses of the Partnership for the year to a maximum of \$10,000 per LP Unit. As a result their share of non-capital losses is not available to Sustainable Energy to offset future taxable income realized by it.

The financial results of STGLP have been consolidated with the financial results of Sustainable Energy since inception as SES has full control over the operations of STGLP and Sustainable Energy has at all times the right to acquire all the LP Units not held by it directly.

As of February 15, 2006, Sustainable Energy acquired 200 LP Units previously issued by STGLP during the 2005 calendar year (175 LP Units in fiscal 2005 and 25 LP Units in fiscal 2006) in exchange for 9,698,150 common shares of the Company making it the sole limited partner of STGLP. During the 2006 fiscal year STGLP issued 94 LP Units in fiscal 2006 for gross proceeds of \$940,000

Sustainable Energy Technologies Ltd.
Notes to the Consolidated Financial Statements
September 30, 2006

9. SHARE CAPITAL

Authorized

Unlimited number of common shares without par value

Issued common shares

Changes in the Company's common share capital are as follows:

	Number of Shares	Amount
Balance, September 30, 2004	42,038,820	10,574,894
Private placement for cash	1,000,000	150,000
Financing costs of private placement	—	(21,692)
Issued in exchange for units of SMLP	8,666,580	1,560,000
Financing costs of SMLP units exchange	—	(228,604)
Conversion of first preferred shares, series 3	79,500	9,778
Cancellation of escrow shares	(2,000,000)	—
Exercise employee stock options	300,000	53,580
Exercise broker warrants	163,888	47,282
Controlling interest in STGLP (note 8)	—	1,464,714
Private placement for cash	1,851,852	500,000
Financing costs of private placement	—	(66,025)
Conversion of first preferred shares, series 5	4,501,738	567,593
Conversion of first preferred shares, series 6	2,728,770	434,924
Balance, September 30, 2005	59,331,148	\$ 15,046,444
Exercise broker warrants	94,444	33,405
Conversion of first preferred shares, series 5 (note 7)	16,167	2,087
Issued in exchange for units of STGLP (note 8)	9,698,150	535,287
Financing costs of STGLP units exchange	—	(313,823)
Controlling interest in STGLP (note 8)	—	858,731
Balance, September 30, 2006	69,139,909	\$ 16,162,131

Sustainable Energy Technologies Ltd.
Notes to the Consolidated Financial Statements
September 30, 2006

9. SHARE CAPITAL (CONTINUED)

Options

The Company has issued options to directors, officers and employees of the Company to acquire common shares as follows:

	Number of Options	Weighted Average Price
Balance, September 30, 2004	4,010,000	\$0.21
Issued	808,005	\$0.17
Exercised	(300,000)	\$0.15
Forfeited	(425,000)	\$0.57
Balance, September 30, 2005	4,093,005	\$0.17
Issued	2,750,000	\$0.18
Exercised	—	—
Forfeited	(210,000)	\$0.25
Balance, September 30, 2006	6,633,005	\$0.18

Additional details on the Company's stock options outstanding at September 30, 2006 are as follows:

Range of Exercise Prices	Options	Outstanding Options Weighted Average Price	Weighted Average years to expiry	Exercisable Options Options	Weighted Average Price
\$0.10 - \$0.16	950,000	\$0.12	0.98	950,000	\$0.12
\$0.17 - \$0.19	4,308,005	\$0.18	4.10	944,335	\$0.18
\$0.20 - \$0.25	1,375,000	\$0.20	1.33	904,999	\$0.20
\$0.10 - \$0.25	6,633,005	\$0.18	3.08	2,799,334	\$0.17

Stock-Based Compensation Plan

Effective October 1, 2003, Canadian accounting standards require recognition of compensation costs arising out of stock-based compensation plans. In 2003, the Company prospectively adopted this requirement. Had the fair value method been adopted at January 1, 2002, the Company's net loss and loss per share would have approximated the following pro forma amounts, without utilizing the transitional rules provided under section 3870 of the CICA handbook:

	September 30, 2006	September 30, 2005
Compensation Costs Change	\$ -	\$ 47,578
Net loss		
As reported	\$ (2,742,589)	\$ (2,439,351)
Pro forma	\$ (2,742,589)	\$ (2,486,929)
Loss per common share		
Basic		
As reported	\$ (0.04)	\$ (0.05)
Pro forma	\$ (0.04)	\$ (0.05)
Diluted		
As reported	\$ (0.04)	\$ (0.05)
Pro forma	\$ (0.04)	\$ (0.05)

Sustainable Energy Technologies Ltd.

Notes to the Consolidated Financial Statements

September 30, 2006

9. SHARE CAPITAL (CONTINUED)

Options generally vest over a 3-year period with 1/6 vesting every 6 months but vesting terms are at the discretion of the Board. The Company's plan allows for a maximum term on any options to be five years. Up to 10% of the outstanding shares can be issued as options at the discretion of the Board of Directors, with the minimum price being the closing price on the TSX Venture Exchange on the date of issue.

The fair value of the options issued was estimated at the date of granting using the Black-Scholes option-pricing model with the following weighted average assumptions: risk free rate 4.25%, expected life 3.5 years, expected volatility of 91% and expected dividend yield of nil. The weighted average value per option is \$0.12 (2005 - \$0.13)

Compensation expense of \$159,900 was charged to general and administrative and to contributed surplus to September 30, 2006 (\$108,189 to September 30, 2005) for options.

Warrants

Changes in the Company's purchase warrants are as follows:

	Issued with common shares	Broker warrants	Total purchase warrants	Allocated fair market value
Balance, September 30, 2004	983,750	32,400	1,016,150	—
Issued on issuance of SMLP Units and Common Shares in private placement	—	966,659	966,659	\$ 104,883
Issued on issuance of STGLP Units in private placement	—	694,445	694,445	\$ 120,625
Issued on issuance of STGLP Units and Common Shares in private placement	—	351,855	351,855	\$ 51,194
Warrants exercised	—	(163,888)	(163,888)	\$ (17,782)
Warrants cancelled upon expiry	(983,750)	(32,400)	(1,016,150)	—
Balance, September 30, 2005	—	1,849,071	1,849,071	\$ 258,920
Issued on issuance of STGLP Units in private placement	—	108,695	108,695	\$ 7,598
Issued on issuance of STGLP Units in private placement	—	345,000	345,000	\$ 18,524
Issued on issuance of STGLP Units in private placement	—	105,000	105,000	\$ 7,340
Issued on issuance of STGLP Units in private placement	—	15,000	15,000	\$ 1,049
Warrants exercised	—	(94,444)	(94,444)	\$ (16,405)
Warrants cancelled upon expiry	—	(1,754,627)	(1,754,627)	\$ (242,515)
Balance, September 30, 2006	—	573,695	573,695	\$ 34,511

The fair value of the warrants issued was estimated at the date of granting using the Black-Scholes option-pricing model with the following weighted average assumptions: risk free rate 3.0%, expected life 1.1 years, expected volatility ranging from 99% - 136% and expected dividend yield of nil.

Warrant compensation expense of \$34,511 was charged to share issuance costs and to warrants to September 30, 2006 (\$276,702 to September 30, 2005).

Sustainable Energy Technologies Ltd.
Notes to the Consolidated Financial Statements
September 30, 2006

9. SHARE CAPITAL (CONTINUED)

The 966,659 broker warrants issued with the SMLP units were exercisable prior to May 29, 2006 and entitled the holder to acquire 1 common share at \$0.18. During the year, all the broker warrants expired.

The 694,445 broker warrants issued with the STGLP units were exercisable prior to August 19, 2006 and entitled the holder to acquire 1 common share at \$0.18. During the year, 94,444 broker warrants were exercised, with the remaining unexercised broker warrants expiring.

The 351,855 broker warrants issued with the STGLP units were exercisable prior to September 8, 2006 and entitled the holder to acquire 1 common share at \$0.30. During the year, all the broker warrants expired.

The 108,695 broker warrants issued with the STGLP units are exercisable prior to December 22, 2006 and entitle the holder to acquire 1 common share at \$0.23.

The 345,000 broker warrants issued with the STGLP units are exercisable prior to July 17, 2007 and entitle the holder to acquire 1 common share at \$0.20.

The 105,000 broker warrants issued with the STGLP units are exercisable prior to July 23, 2007 and entitle the holder to acquire 1 common share at \$0.20.

The 15,000 broker warrants issued with the STGLP units are exercisable prior to August 28, 2007 and entitle the holder to acquire 1 common share at \$0.20.

10. PER SHARE AMOUNTS

The following table illustrates the number of shares, which were added to the weighted average number of common shares outstanding for the dilutive effect of convertible securities:

	September 30, 2006	September 30, 2005
Warrants	126,785	74,852
Stock options	2,327,028	1,896,881
Preferred shares	-	6,908,027
	<u>2,453,813</u>	<u>8,879,760</u>

11. RELATED PARTY TRANSACTIONS

Sustainable Energy expensed \$150,000 as compensation for consulting services from the Chief Executive Officer (September 30, 2005 - \$150,000) provided through a company he owns. The Chief Executive Officer is also a director and a major shareholder of the Company. On September 30, 2006, Sustainable Energy owed this related party a total amount of \$ 62,500 (September 30, 2005 - \$ 17,294).

Certain directors and officers have from time to time participated in the issue of LP Units of STGLP purchasing a total of 18.5 LP Units for a total consideration of \$185,000 . (Note 19: Subsequent Events)

	2006 LP Units	2005 LP Units
LP Units Issued to Directors & Officers	Nil	18.5
Total Amount Invested	Nil	\$185,000

The Company expensed \$Nil (2005-\$4,572) as compensation for consulting services provided by one of the directors. At September 30 2006, Sustainable Energy owed \$Nil (September 30, 2005: 4,572)

Sustainable Energy Technologies Ltd.

Notes to the Consolidated Financial Statements

September 30, 2006

12. GOVERNMENT ASSISTANCE

Sustainable Energy has received contributions to non-recurring engineering related to the development of its technologies and to marketing from U.S. and Canadian Government agencies. The contributions have been deducted in calculating the Company's investment in technology development (see note 4) or from the expense to which they relate. These amounts, plus, in certain cases, an implied return on the investment, are repayable as a percentage of the Company's revenues. Since the repayments are tied to the amount of revenues that may be earned in future periods, repayment of these contributions will be treated as a royalty expense in the period in which the revenue is earned.

During the period, a total of \$76,674 (September 30, 2005 - \$ 6,000) was received as government assistance. Of this amount, \$66,791 (September 30 2005 - \$ nil) is repayable based on gross sales revenues. Operating expenses have been credited with this government assistance.

Spokane Intercollegiate Research and Technology Institute ("SIRTI")

Through fiscal 2000 and 2001, the Company received government funding toward the development of the power converter in the amount of \$295,851 (\$196,263 US). A royalty of 4% of the revenue from the resulting products (as defined in the agreement) is payable until SIRTI has recovered four times its investment in the program or until March 31, 2007, whichever is earlier. A royalty of \$2,169 (September 30, 2005 - \$14,544) payable February 1, 2007 has been accrued in these financial statements. The remaining royalty potentially payable is \$742,269 US. Payment of the remaining maximum amount payable to SIRTI implies the realization by the Company of revenues for the sale of power inverter products totaling \$18,556,725 US.

National Research Council

Through fiscal 1999 and 2000, the Company received funding in the amount of \$438,870 from the National Research Council Technology Partnership Canada ("TPC") toward costs incurred to obtain certification of the SL Series Wind Turbine. A royalty of ½% of gross revenue after 2001 (maximum \$90,000 per year) is payable until TPC has recovered one and a half times the amount advanced to the Company. A royalty of \$902 (September 30, 2005 - \$1,211), payable September 30, 2006, has been accrued in these financial statements. The remaining royalty potentially payable is \$647,448. Payment of the maximum royalty payable to TPC implies the realization by the Company of sales revenues totaling \$129,489,600.

During the 2006 fiscal period, the Company entered into a Contribution Agreement with TPC to fund a portion of the cost incurred for various product development and enhancement programs related to the power inverter platform, from December 12, 2005 to March 31, 2007 to a maximum of \$245,241. The Company has received or accrued \$66,791 to the end of the 2006 fiscal period. A royalty of 1.9% of gross revenue after April 1, 2008 is payable by Sustainable Energy until TPC has recovered one and a half times the amount advanced to the Company.

Natural Resources Canada

In fiscal 2003, the Company received a contribution in the amount of \$100,000 from Natural Resources Canada under an Efficiency and Alternative Energy Contribution Agreement towards costs incurred to further the commercialization of its solar inverter. A royalty equal to 2% of revenues in respect of the licensing, selling, marketing or commercialization of any Intellectual Property developed in the project is payable until the Government of Canada has received a return of its investment. A royalty of \$1,362 (September 30, 2005 - \$ 674) payable October 31, 2006 has been accrued in these financial statements. The remaining royalty potentially payable is \$97,964. Payment of the maximum royalty payable to Natural Resources Canada implies the realization by the Company of revenues from the sale of the solar inverter totaling \$4,898,200.

Sustainable Energy Technologies Ltd.
Notes to the Consolidated Financial Statements
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13. INCOME TAXES

	September 30, 2006	September 30, 2005
Loss before taxes	\$ (2,742,589)	\$ (2,439,351)
Expected tax recovery at combined federal and provincial statutory rates of 32.87% (September 30, 2005 - 34.62%)	(901,489)	(844,503)
Decrease (increase) resulting from:		
Permanent differences	60,000	65,917
Share issue costs	—	(17,283)
Non-capital losses (net of valuation allowance)	841,489	795,869
Future income tax recovery expense	\$ —	\$ —

Future income taxes consist of the following temporary differences:

	September 30, 2006	September 30, 2005
Development costs and capital assets	\$ (1,250,000)	\$ (1,512,885)
Non-capital loss carry-forwards	3,060,000	2,899,597
Scientific research expenditure pool	240,000	257,207
Share issue costs	110,000	45,302
	2,160,000	1,689,221
Valuation allowance	(2,160,000)	(1,689,221)
	\$ —	\$ —

The Company has available non-capital loss carry-forwards in the amount of \$9,300,000 that may be deducted in determining the taxable income of future years. Non-capital losses expire during the years 2006 to 2020.

14. COMMITMENTS

- a) At September 30, 2006, Sustainable Energy had operating commitments for inventory, premise and operating equipment leases as follows:

2007	\$ 192,000
2008	\$ 34,200
2009	\$ —
Thereafter	\$ —

- b) Consulting services (and accrued interest) in the amount of \$148,308 (\$100,215 US) were provided in fiscal 1998 to the Company. Repayment is contingent upon SEL achieving sales (\$ nil to date) or capital funding of \$2,000,000 US (\$342,000 US has been realized to September 30, 2006). The amount advanced bears interest at an annual rate of 20%.
- c) Sustainable Energy guaranteed the salary of one of its employees. At September 30, 2006 the amount guaranteed was \$142,460, which is held in trust by the Company's legal counsel.
- d) The Company has agreed to non-cancelable inventory purchase commitments for specific inventory items in the amount of \$127,300. This inventory will be purchased within the next fiscal year.

Sustainable Energy Technologies Ltd.

Notes to the Consolidated Financial Statements

September 30, 2006

14. COMMITMENTS (CONTINUED)

- e) Under the STGLP Limited Partnership Agreement, Sustainable Energy must make an offer to purchase all the LP Units not owned by it on April 15, 2007, in exchange for common share of the Company based on the fair market value of the LP Units as of March 31, 2007. The Company, however, has the right to acquire all the currently issued LP Units not already owned by it in exchange for common shares of the Company at an effective price of \$0.18 per share, and it is management's intention to do so.
- f) In June, 2006 Sustainable Energy entered into a supply contract for delivery of SUNERGY 5kW inverters to a leading European manufacturer of solar PV modules. The contract calls for a delivery of inverters to a large project in Spain over a period of 6 months. No penalties are prescribed under the supply contract for late or non delivery of the inverters. The supply contract is insured by the Export Development Corporation against non-performance by the customer to a maximum amount of \$390,000.

15. BUSINESS RISK

The nature of the Company's operations exposes the Company to fluctuations in commodity prices (steel and copper costs in raw materials), exchange rates, and interest rates. The Company monitors and, when appropriate, utilizes financial instruments to manage its exposure to these risks.

The Company has *foreign exchange risk* because it is exposed to foreign currency fluctuations in its US dollar denominated payables, receivables and long-term debt.

The Company has *credit risk* because it extends unsecured credit to its customers, but mitigates this risk by dealing with financially sound companies and, accordingly, does not anticipate any significant credit losses.

16. FINANCIAL INSTRUMENTS

Fair value estimates are made as of a specific point in time using specific available information about the financial instrument. These estimates are subjective in nature and often cannot be determined with precision. Fair values of other financial assets and liabilities included in the consolidated balance sheets are as follows:

- For accounts receivable and advances, accounts payable, accrued liabilities and preferred shares, the carrying amounts in the consolidated balance sheets approximate the fair value due to the short maturity of these instruments.
- The estimated fair value of the long-term debt (see note 6) is based on the future cash flow associated with the instrument discounted using a current market rate for a similar debt instrument of comparable maturity, and is estimated at \$409,000 (September 30, 2005 - \$377,000).

17. GEOGRAPHIC DISCLOSURES

	September 30, 2006		September 30, 2005	
	Revenues	Assets *	Revenues	Assets *
Canada	\$ 80,225	\$ 120,525	\$ 24,236	\$ 140,889
United States	9,530	4,059,542	132,364	4,540,089
Europe	68,114	—	73,421	—
	\$ 157,869	\$ 4,180,067	\$ 230,021	\$ 4,680,978

Assets refer to the Company's development costs and capital assets. Engineering fees are attributed to the country in which the service is rendered. Product revenues are attributed to the country of delivery.

Notes to the Consolidated Financial Statements

September 30, 2006

18. ECONOMIC DEPENDENCE

All revenues were from four customers in fiscal 2006 (2005 – three).

19. SUBSEQUENT EVENTS

On November 1 2006, the Company borrowed \$500,000 from a Canadian Chartered Bank. The loan bears interest at prime plus 2% and must be repaid in eight (8) principal payments of \$62,500 beginning September 30 2007. The loan is guaranteed by the Export Development Corporation as to \$375,000 and by the Chief Executive Officer of the Company as to \$125,000. In consideration of his guarantee, the Company has, subject to approval by the TSX Venture Exchange, agreed to issue to 300,000 warrants to acquire common Shares of the Company at a price of \$0.15 per share exercisable during the term of the credit.

On December 29, 2006 STGLP completed a private placement of 125 LP Units at \$10,000 per LP unit to raise gross proceeds of \$1,250,000. In connection the Company issued broker warrants to acquire 961,538 at a price of \$0.13 per share exercisable until June 21, 2008. Certain directors and officers subscribed for a total of 10 LP Units for an aggregate consideration of \$100,000. As at the date hereof, there were 219 LP Units of STGLP issued and outstanding and not owned by the Company. Under the Partnership Agreement Sustainable Energy has the right to and management intends to acquire the LP Units for a total of 14,837,607 Common Shares (average \$0.15 per share)

The Company has also agreed to accelerate deliveries of inverters under its current supply contract so that the entire order will be filled by the end of July 2007.

